

## III.E.2. Corporate Tax Shelter Check Sheet

**Objective:** The objective of this check sheet is to assist examiners in identifying corporate tax shelters. “Yes” answers may be an indication of a corporate tax shelter.

Nine characteristics of corporate tax shelters have been identified and should be kept in mind whenever examining a transaction. (Includes foreign sales corporations and grantor trusts).

1. Lack of economic substance. Look for transactions that result in an attribute such as a capital gain to offset an otherwise non-deductible capital loss or foreign source income to absorb foreign tax credits, particularly if the foreign tax credits will expire soon.
2. Inconsistent financial accounting and tax treatment.
3. Existence of tax indifferent parties.
4. Complexity of the transaction for no apparent reason other than to make the transaction difficult to understand, thereby avoiding detection.
5. Unnecessary steps or novel investments.
6. Marketing activity. Is a national financial services firm such as a broker or lender promoting this transaction?
7. Confidentiality - for example, does the instrument/agreement prohibit *disclosure* to regulatory agencies?
8. Contingent or refundable fees and rescission or insurance arrangements.
9. High transaction costs.

	Yes	No
<b>1. Schedule M-1</b> a. Is the taxpayer claiming material losses or credits? b. Is there a general or unusual entry? c. Does the net income per books on Schedule M-1 reconcile to actual net income per books?		
<b>2. IRC §351 transactions:</b> a. Does the taxpayer disclose any Section 351 transfers? b. If yes, whose stock was involved in the exchange? (In some instances, stock issued by a subsidiary may be worthless.) c. If no IRC §351 transaction disclosed, is there a substantial increase in total assets and/or stock on the balance sheet that may indicate a Section 351 transaction? Increase in total assets _____ Increase in common or preferred stock _____ d. Is there a disparity in value between the assets and stock involved in the exchange? e. Does the appraisal appear to overstate the fair market value of the assets and/or the stock involved in the exchange? f. Is the section 351 transaction with a national leasing company? (Some		

<p>companies have a history of engaging in shelter activities.)</p> <p>g. Is a tax indifferent party in anyway associated with the transaction? For example, a tax indifferent party may be a partner in a partnership that is involved in the transaction. (A tax indifferent party is a party that is exempt from U.S. income tax. Examples include Section 501 entities, the Indian Nation, foreign partnerships and foreign corporations not doing business in the U.S.)</p> <p>h. Was any cash involved in the transaction? (The cash may be a disguised fee to the accommodating party for entering into the transaction.)</p>		
	Yes	No
<p><b>3. Leasing:</b></p> <p>a. Is the leasing activity outside the corporation's core business? (For example, a utility company entering the computer leasing business.)</p> <p>b. Are there steps in a transaction that are unnecessary to achieve the corporation's purported business purpose?</p> <p>c. Is the transaction with a tax indifferent party?</p> <p>d. Are there sales/leaseback transactions? (These transactions require close scrutiny.)</p>		
<p><b>4. Subsidiaries:</b></p> <p>a. Is there a subsidiary with little or no activity in prior years with material losses in the current year?</p> <p>b. Is the subsidiary engaging in an activity outside the corporation's core business?</p> <p>c. Were any subsidiaries incorporated for the purpose of a single transaction?</p>		
<p><b>5. International aspects:</b></p> <p>a. Did the taxpayer claim large capital gains that involve foreign entities where foreign tax credits are released?</p> <p>b. Did the taxpayer engage in any cross border equity swaps?</p> <p>c. Did the taxpayer engage in any debt swaps that freed up foreign tax credits?</p> <p>d. Did the taxpayer engage in any IRC §357(c) basis-shift transactions? (If yes, look for multiple transfers of assets secured by the same liability.)</p> <p>e. Did the taxpayer acquire an asset that generates an income stream subject to foreign withholding tax? If yes, was there an effective duplication of tax benefits through the use of structures designed to exploit inconsistencies between U.S. and foreign tax laws?</p> <p>f. Does the taxpayer have Foreign Sales Corporations (FSC) that are involved in a leasing business?</p> <p>g. Dividend/Basis split issues:</p> <p>i. Did the taxpayer control a foreign corporation through the attribution rules of IRC §318(a)(4)? Be especially on the lookout for the existence of warrants. (This can usually be found on Form 5471, Schedule O.)</p> <p>ii. Did the "controlled foreign corporation" redeem stock in an unrelated foreign corporation whose stock the taxpayer also owns?</p> <p>iii. If yes, did the corporation sell its stock to the same foreign entity? (These transactions mostly involve foreign banks.)</p> <p>iv. If yes, did the taxpayer increase its basis in the stock by the amount of a dividend recognized by the foreign entity in (g)(i)?</p>		
<p><b>6. Financial products:</b></p> <p>a. Did the taxpayer issue any "exotic" instruments, such as PEPS (Premium</p>		

<p>Equity Participating Securities)?</p> <ul style="list-style-type: none"> <li>i. Is the classification of the instrument questionable?</li> <li>ii. If yes, how was it classified? _____</li> <li>iii. If the instrument was classified as debt, is it really equity?</li> <li>iv. Was the instrument correctly valued?</li> <li>v. Is the interest rate on any claimed debt instrument below the current market rate, given the risk level of the security?</li> </ul> <p>b. Are there related parties involved?</p> <p>c. Did the taxpayer engage in any transactions involving fast pay stock or “step down preferred stock?”</p> <p>d. Did the taxpayer engage in any transactions with circular cash flows?</p> <p>e. Did the taxpayer engage in any transaction through a promoter?</p> <ul style="list-style-type: none"> <li>i. If yes, were the fees paid to the promoter high compared with the pre-tax economic benefit?</li> <li>ii. Did the promoter’s fee depend on the level of tax savings realized?</li> <li>iii. Was the taxpayer required to sign a non-disclosure agreement?</li> <li>iv. Did the transaction have other high transaction costs, such as, fees paid to a tax-indifferent party, or legal fees?</li> <li>v. Does the transaction involve insurance or rescission arrangements by which the promoter will refund fees or otherwise absorb cost of the taxpayer if the IRS successfully challenges the shelter?</li> </ul> <p>f. Are there steps in any transaction that are unnecessary to achieve the corporation’s purported business purpose?</p>	<b>Yes</b>	<b>No</b>
<p><b>7. Sales Transactions:</b></p> <ul style="list-style-type: none"> <li>a. Was there a highly leveraged, material, purchase of assets?</li> <li>b. If an appraisal was used to value the assets, does the fair market value appear overstated?</li> <li>c. Were the assets subsequently disposed of in a section 351 transfer?</li> </ul>		